BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of	)	
	)	No. 87A-0483-SS
MELVIN A. AND ADELE R. GUSTAFSON	)	
	)	

For Appellant: Nathan Fligsten
Certified Public Accountant

For Respondent: John Stillwell, Jr.
Counsel

OPINION

This appeal is made pursuant to section 18593 1/ of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Melvin A. and Adele R. Gustafson against proposed assessments of additional personal income tax in the amounts of $6,022.71 and $3,173.00 for the years 1979 and 1980, respectively.

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the years in issue.

The issues for determination are whether appellants have shown that (1) they are entitled to a credit for taxes paid to Nebraska on net income earned from employment with a Nebraska corporation involving consultation by telephone from California, and (2) the Franchise Tax Board's formula for apportioning appellants' California and Nebraska earnings was arbitrary or unreasonable.

Appellants, California residents, claimed credits on their 1979 and 1980 joint personal income tax returns for net income taxes paid to the State of Nebraska in the amounts of $10,513 and $5,332, respectively, for appellant-husband's employment with a Nebraska meat-packing company. Appellant-husband, hereinafter referred to as 'appellant', served as general consultant to the resident operating manager of the packing plant and claimed to be 'regularly engaged in all the decision-making problems of top management, such as plant location and expansion, processing and marketing techniques, selection and establishment of product lines and production innovations, financial management, labor problems, etc.' He claimed to 'also [have] important responsibilities for personal. services to several other corporations in California and Texas' and stated that his time spent working-for the Nebraska corporation was limited to three weeks spent in Omaha and phone calls from Los Angeles of 15-30 minutes each approximately three times a week. Appellant stated that "no part of the packing-plant business of this Nebraska company took place in California, whether it was purchasing, procurement, manufacturing, selling, manufacturing or any other commercial activity whatsoever that could be considered 'business' or related to the production of its income."

Respondent Franchise Tax Board issued a notice of proposed assessment for each of the taxable years 1979 and 1980 disallowing certain depreciation deductions and limiting the credits for taxes paid. to Nebraska. Based upon appellant's admission that he was physically present in Nebraska for only three weeks during a year of personal services performed for the Nebraska corporation, respondent concluded that 94.23 percent of appellant's compensation from the Nebraska corporation was attributable to California and only 5.77 percent to Nebraska. Respondent accordingly disallowed a portion of the credit. Appellant protested, arguing that 100 percent of the compensation from the Nebraska corporation should be attributed to Nebraska because "100% of such services pertained to Nebraska business, and no California business whatsoever was ever involved..

Respondent revised its computations in its notice of action to reflect a determination that appellant did not spend

all his California time working for the Nebraska corporation. It apportioned appellant's Nebraska corporation income by using the proportion his Nebraska corporation income bore to his total income to determine the number of weeks each year that were attributable to his Nebraska corporation employment. As a result of that revision, the allowable credit for tax paid to Nebraska was increased from $5,131 to $5,638 for 1979 and from $1,601 to $2,048 for 1980. (Resp. Reply Br. at 2.)

Appellants responded by disputing the reasonableness of FTB's apportionment.

Section 18001 of the Revenue and Taxation Code provides that a credit against California income taxes is available for income taxes paid to another state on income 'derived from sources within that state which is taxable under its laws irrespective of the residence or domicile of the recipient.' The regulation interpreting section 18001 limits credits to taxes 'on income from personal services performed within such state, from land or other property located therein, from business carried on there or otherwise derived from sources within such state and taxable under the laws of such state irrespective of the residence or domicile of the recipient.' (Cal. Admin. Code, tit. 18, reg. 18001-2, subd. (a).) This board has held that 'the effect of the regulation is to consider the source of the income as the place where the services are performed.' (Appeal of Leland M. and June N. Wiscombe, Cal. St. Bd. of Equal., Aug. 19, 1975; Appeal of Jack and Sandra M. Sanguin, Cal. St. Bd. of Equal., Sept. 15, 1983.) Therefore, appellant's argument that the income should be 100 percent attributable to Nebraska is unavailing.

How to apportion the income earned from the Nebraska corporation between Nebraska and California in order to determine the proportion of the Nebraska tax available as a credit, however, is a more complicated question. In the above-cited Wiscombe decision, this board was not required to decide the apportionment issue, because the parties had stipulated that the taxpayers were physically present in California for half of the time they had spent working for the out-of-state employer. In the instant appeal, on the other hand, appellant claims to have spent a minimal amount of time performing his duties for the Nebraska corporation. He states that he spent two to three weeks in Nebraska and 15-30 minutes three times a week consulting by phone from California. A strictly time-based apportionment, then, assuming two 40-hour work weeks in Nebraska and three 30-minute calls a week for the remaining 50 weeks in California, would result in a ratio of 75 hours of California income to 80 hours of Nebraska-income - a credit factor of approximately 51.6 percent. Assuming three weeks in Nebraska, the credit factor would be as much as 76.1 percent.

Respondent declined to use a strictly time-based method of apportionment, however, arguing that 'the number and duration of the telephone conversations are not determinative in this matter.' (Resp. Br. at 8.) According to respondent, 'Appellant-husband was compensated for his availability for such consultations, not for a particular number or duration of them.' (Id.) Therefore, respondent concluded that appellant should be deemed to have worked in California for the Nebraska corpo- ration for the same portion of the total year as the Nebraska corporation income bore to appellant's total income.

The provision'for tax credit under section 18001 is in 'effect an 'exemption. from liability for a tax already determined and admittedly valid, and is therefore strictly construed against the taxpayer. (Miller v. McColgan, 17 Cal.2d 432 [110 P.2d 419] (1941).) Moreover, this section is not a panacea for all double taxation. The courts have made it clear that the goal of limited protection against double taxation cannot be used to invoke the provision where California law establishes a California situs for the source of the income. (Christman v. Franchise Tax Board, 64 Cal.App.3d 751 (134 Cal.Rptr. 725] (1976).) Where respondent has applied a formula for allocation of income, the taxpayer bears the burden of showing that the application is intrinsically arbitrary or that it produced an unreasonable result. (Cf. Appeal of Union Carbide and Carbon Corp., Cal. St. Bd. of Equal., Aug. 19, 1957, and cases cited therein.)

The question of whether another state has properly taxed the same income as taxed by California is not material in an appeal to this board. (Appeai of The Lane Company, Inc., Cal. St. Bd. of Equal., Dec. 13, 1961.) Other than to assert repeatedly and without-substantiation that all business activities were attributable to Nebraska and his earnings were 'in no way connected or related to the amount of days or hours he was physically present in Nebraska compared with California,' appellant has provided no information with regard to the actual basis for his earnings. If the services he performed during his visits to Nebraska, for example, were of greater value or generated a greater pro rata amount of income for appellant than the phone calls made from California, appellant should have so demonstrated. As is, appellant has failed to meet his burden of proving that respondent's revised method of allocating appellant's Nebraska corporation income is intrinsically arbitrary or unreasonable.

For the above reasons, respondent's action in this appeal will be sustained.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Melvin A. and Adele R. Gustafson against proposed assessments of additional personal income tax in the amounts of $6,022.71 and $3,173.00 for the years 1979 and 1980, respectively, be and the same is hereby modified in accordance with the concessions of the Franchise Tax Board. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 29th day of November 1988, by the State Board of Equalization, with Board Members Mr. Carpenter, Mr. Collis and Mr. Davies present.

_____, Chairman

Paul Carpenter, Member

Conway H. Collis, Member

John Davies*, Member

_____, Member

*For Gray Davis, per Government Code section 7.9